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PACIFIC  **TELESIS**
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September 9, 1994

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William F. Caton
Acting Secretary
Federal Communications Commission
Mail Stop 1170
1919 M Street, N.W., Room 222
Washington, D.C. 20554

DOCKET FILE COPY ORIGINAL

Dear Mr. Caton:

Re: *PP Docket No. 93-253 - Implementation of Section 309(j) of the Communications Act - Competitive Bidding*

On behalf of Pacific Bell Mobile Services, please find enclosed an original and six copies of its "*Opposition and Comments*" in the above proceeding.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions or require additional information concerning this matter.

Sincerely,



Enclosures

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Before the
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In the Matter of

Implementation of Section 309(j)
of the Communications Act -
Competitive Bidding

PP Docket No. 93-253

DOCKET FILE COPY ORIGINAL

OPPOSITION AND COMMENTS OF PACIFIC BELL MOBILE SERVICES

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Date: September 9, 1994

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SUMMARY

Pacific Bell Mobile Services hereby opposes and comments on selected issues raised in the petitions for reconsideration. We oppose requests that additional spectrum be set aside for designated entities and that financial incentives for designated entities be applied to any broadband license. We oppose GTE's request to change the activity rule. However, we suggest that those administering the auctions have the discretion to postpone the onset of Phases II and III of the auction. In addition, we propose that bidders be allotted one waiver for each twenty rounds of bids.

We oppose McCaw's proposal with respect to the time allotted for each bidding round. However, we agree the bidders do need adequate time to evaluate bidding information and we recommend that initial rounds be at the rate of one round per day and that throughout the auction a round last a minimum of four hours. We also urge the Commission to announce the parameters for bidding rounds as soon as possible since prospective bidders need this information in developing bidding support systems.

We oppose Metrex's proposal with respect to the stopping rule and we continue to support the simultaneous closing

closing rule. We also oppose any changes in the rules regarding cellular eligibility.

We support the clarification of acceptable management contracts. We support raising the limit of voting stock held by passive investors. Finally, we agree that the current transfer restrictions with respect to designated entities pose a hardship for designated entities that encounter financial difficulties.

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In the Matter of

Implementation of Section 309(j)
of the Communications Act -
Competitive Bidding

PP Docket No. 93-253

OPPOSITION AND COMMENTS OF PACIFIC BELL MOBILE SERVICES

The petitions for reconsideration of the Fifth Report and Order¹ raise many issues relating to the rules for the broadband PCS auctions. Pacific Bell Mobile Services ("PBMS") hereby opposes and comments on selected issues raised in the petitions for reconsideration.

I. **NO ADDITIONAL SPECTRUM SHOULD BE SET ASIDE FOR DESIGNATED ENTITIES.**

Many petitioners seek additional benefits for designated entities ("DEs"). The Association of Independent Designated Entities ("AIDE") seeks to have the financial incentives provided to DEs made available for any broadband

¹ In the Matter of Implementation of Section 309(j) of the Communications Act - Competitive Bidding, PP Docket No. 93-253, Fifth Report and Order, released July 15, 1993 ("Fifth Report and Order").

license.² The United States Interactive and Microwave Television Association ("USIMTA") wants additional spectrum set aside for DEs.³ It proposes that over one-half of the available spectrum be set aside, adding an additional block of 30 MHz licenses and an additional block of 10 MHz licenses.⁴

The Commission was required by Congress "to ensure that small businesses, rural telephone companies and businesses owned by members of minority groups and women are given the opportunity to participate in the provision of spectrum-based services."⁵ It was not required to create set-aside licenses. However, based on the record the Commission concluded that "small entities stand little chance of acquiring licenses in these broadband auctions if required to bid against existing larger telephone, cellular and cable companies."⁶ For this reason, it created a set-aside for a block of 30 MHz spectrum and a block of 10 MHz spectrum based on comments that supported this amount of spectrum.

² AIDE, p. 16.

³ USIMTA, p. 3.

⁴ Id. at p. 4.

⁵ 47 U.S.C. §309(j)(4)(D).

⁶ Fifth Report and Order, para. 121.

USIMTA provides no support for its request for additional spectrum other than its general statement that "Reserving as much as one-half of broadband PCS spectrum for bidding by designated entities would result in a more level playing field and also fulfill Congress's mandate that designated entities have the opportunity to participate in providing PCS services."⁷

Congress required that the Commission provide opportunities for DEs but it did not mandate that such opportunity must include a set-aside of one half of the available spectrum. In fact, one-third of the licensed spectrum and nearly one-half of the broadband licenses have been set aside for DEs. USIMTA's position provides no basis for a reconsideration of the rule with respect to DEs and it should be rejected.

With respect to permitting DEs to use their financial incentives for any license, the Commission chose to provide financial incentives with a set-aside structure because it concluded that financial incentives provided across the board would not have a meaningful effect.⁸ The record supports this

⁷ USIMTA, p. 4.

⁸ Fifth Report and Order, para. 131.

conclusion. Commenters stated that bidding credits, even very high ones, would not be effective if small entities are bidding against large ones.⁹ Consequently, there is no reason to extend financial incentives beyond the set-aside blocks. The Commission should retain its current rule that provides financial incentives to DEs within the set-aside spectrum blocks and it should not increase the amount of spectrum set-aside.

II. GTE'S PROPOSAL TO MODIFY THE ACTIVITY RULE SHOULD BE REJECTED.

GTE argues that the current activity rule is too complex.¹⁰ It urges the Commission to adopt the original Milgrom-Wilson proposal that requires a bidder to remain active on one property in a round in order to remain eligible to bid later on any property or combination of properties for which the bidder has applied and made sufficient upfront deposits.¹¹

The initial proposal was modified by Professors Wilson and Milgrom out of consideration of how best to ensure a timely completion of the auction and to minimize strategic behavior. See the attached Affidavit of Professor Milgrom. As he states, requiring bidders to be active on one-third of the spectrum for

⁹ Id.

¹⁰ GTE, p. 16.

¹¹ Id. at p. 18.

which they wish to remain eligible in the first phase of auction is a reasonable and workable restriction for the first rounds of the auction. If the auction never leaves Phase I, it is not a problem no matter how many rounds there are in Phase I. For this reason, Professor Milgrom suggests that those administering the auction be allowed the discretion to determine the length of time allotted for each round¹² and the minimum bid increment as well as the discretion to postpone the onset of Phases II and III. However, the administrator would also retain the option to proceed to Phase II or III to guard against an excessively long auction.

Because these modifications may result in many more rounds taking place in Phase I, it is important that bidders be provided with more than one waiver per phase.¹³ For this reason, we propose that a bidder be allowed to exercise one waiver every 20 rounds, in other words, one waiver in rounds 1-20, one in rounds 21-40, etc. See attached Affidavit. Bidders would not be permitted to carry forward unused waivers from one set of rounds to another.

¹² The Commission should set time parameters for bidding rounds as discussed in the next section. Those administering the auction would have discretion within these parameters.

¹³ See, Fifth Report and Order, para. 56.

These modifications with respect to activity rules should be incorporated into the broadband auction design rather than GTE's proposal. GTE's proposal lacks a mechanism to assist in bringing the auction to a timely close. With the modifications, our proposal provides both bidder flexibility and the ability to invoke different phases, if necessary, to assist in bringing the auction to a timely close.

III. MCCAW'S PROPOSAL TO LIMIT BIDDING IN THE EARLY STAGES TO TWO ROUNDS PER WEEK AND IN LATER STAGES TO ONE ROUND PER WEEK MUST BE REJECTED.

McCaw is concerned that bidders have adequate time to assess the round's high bids as they relate to a bidder's strategy for a number of licenses.¹⁴ For this reason, McCaw proposes that there be only two rounds per week in the early stages and only one round per week in the later stages.¹⁵

McCaw's proposal would result in an excessively long auction and would needlessly delay the introduction of PCS services. See attached Affidavit. For example, under McCaw's proposal the narrowband auctions would have lasted 42 weeks. The broadband auction could conceivably last over 100 rounds. This would mean that under McCaw's proposal the auction could

¹⁴ McCaw, pp. 4-5.

¹⁵ Id. at p. 4.

last two years unless the Commission invokes the emergency termination rule, announcing that there will be only three more rounds. This is a very undesirable scenario. See attached Affidavit.

Moreover, McCaw's argument that so much time is needed between rounds to obtain financing is seriously flawed. The valuation of licenses and financing commitments will be worked out in most cases prior to the auctions. In addition, the Milgrom-Wilson activity rule allows adequate slack in phases one and two to allow time to arrange increased financing. See attached Affidavit. McCaw's proposal is unnecessary and far too rigid. It must be rejected.

Nevertheless, McCaw does raise a valid issue regarding the appropriate length of bidding rounds. There are a number of factors that must be considered. The appropriate length of rounds is dependent in part on the number of rounds required to complete the auction. The number of rounds is, in turn, dependent upon the value of the licenses and the complexity of back-up strategies.

For broadband licenses, in the early rounds, bidders will have a great deal of information to evaluate because there will be a large number of bidders and their geographic interests still will be undergoing refinement. Nevertheless, in the

initial rounds, since the bids will be relatively low, the decision to continue bidding should come easily to the firms placing the highest values on the licenses. Balancing both of these factors, 24 hours seem an appropriate length for early rounds.

As the auction progresses, there will be fewer licenses actively contested in any round. Consequently, there will be less information to evaluate. In the narrowband auctions, rounds were shortened at this point to good effect. We recommend that this flexibility be available to those administering the auction.

In the process of planning for the broadband auction it is important for prospective bidders to know as soon as possible the time parameters for bidding rounds because this information will heavily influence how they structure their decision support systems for bidding, i.e., software, databases, etc. We recommend that the initial rounds be conducted at the rate of one per day and that throughout the auction a round last a minimum of four hours. We urge the Commission to announce the time parameters for the bidding rounds as soon as possible. Within those parameters, those administering the auction should have the discretion to set round limits as they see fit based on the amount of bidding activity. See attached Affidavit.

IV. METREX'S PROPOSAL TO APPLY UNIFORMLY AN INDIVIDUAL STOPPING RULE FOR ALL BROADBAND PCS BTA LICENSES IS INAPPROPRIATE.

Metrex seeks to modify the auction's stopping rule to stop the bidding for individual licenses on a license-by-license basis after five rounds with no new bidding activity on the license.¹⁶

The experience in the narrowband auction suggests otherwise. See attached Affidavit of Professor Milgrom. The narrowband auctions illustrate a normal pattern of long periods of inactivity on individual licenses followed by bursts of renewed activity. One license drew no bids between round 1 and round 13. Then that particular license became the object of intense interest and its price eventually rose to \$37 million. This would not have been possible under the Metrex approach.

In addition, the Metrex rule would promote strategies that are contrary to determining license value. For example, a bidder might choose to keep its back-up strategy alive by bidding every fifth round on the back-up licenses to keep the bidding on those licenses from closing. See attached Affidavit. The end result would be an increase in the randomness of license

¹⁶ Metrex, p. 1.

assignment without any guarantee that underlying economic values would be reflected in the outcome.

The simultaneous closing rule best allows bidders to express the value of the license through their bids and to pursue back-up strategies as appropriate. Of equal importance, it minimizes the ability of bidders to manipulate the process. It is a critical component of the simultaneous auction design, and it should be retained.

V. RULES RELATING TO CELLULAR ELIGIBILITY SHOULD NOT BE CHANGED.

Both GTE and the Cellular Telecommunications Industry Association ("CTIA") seek reconsideration of the rules relating to cellular eligibility for PCS licenses.¹⁷ CTIA seeks to have access to an additional 5 MHz of spectrum either immediately or at least within one year after service is initiated by the new PCS entrant in the relevant PCS service area.¹⁸ GTE requests that the Commission 1) delete the cellular-PCS cross-ownership restrictions, 2) permit cellular carriers a full opportunity to divest cellular properties in the event of winning a 30 MHz

¹⁷ GTE pp. 2-8; CTIA, pp. 2-4.

¹⁸ CTIA, pp. 2-4.

license and 3) modify its overlap standard for determining cellular eligibility.¹⁹

Both commenters ignore that fact that cellular providers have an enormous headstart in the provision of wireless services. The Commission carefully crafted its rules regarding cellular participation GEN Docket No. 90-314 taking into account the headstart issue.²⁰ It considered identical or similar arguments in that proceeding. Despite strained attempts to relate these issues to rules relating to DEs,²¹ arguments relating to cellular eligibility have no place in this proceeding and should be rejected.

VI. DE FACTO CONTROL ISSUES SHOULD BE CLARIFIED.

Several commenters raise issues relating to management contracts and/or de facto control. Omnipoint urges the Commission to clarify and narrow the focus of the de facto control standard.²² Omnipoint notes that the current

¹⁹ GTE, pp. 6-7.

²⁰ In the Matter of Amendment of the Commission's Rules to Establish New Personal Communications, GEN Docket No. 90-314, Second Report and Order, 8 FCC Rcd 7700, para. 97-111, (1993); Memorandum Opinion and Order; paras. 98-146, released June 13, 1994.

²¹ GTE, p. 4; CTIA, pp. 3-4.

²² Omnipoint, p. 11.

uncertainty contributes to the cost of capital.²³ The National Association of Black Owned Broadcasters, Inc. ("NABOB") urges the Commission to adopt a flexible regulatory structure with respect to management contracts.²⁴

On the other hand, Columbia PCS seeks a less flexible approach urging the Commission to permit only management contracts that are at a subcontractor level for discrete functional responsibilities.²⁵ Columbia PCS asks the Commission to find general contractor types of agreements to be impermissible.²⁶

We do not support the approach taken by Columbia PCS. There is no need to treat management contracts so narrowly. A general contractor type of agreement does not necessarily rise to the level of a de facto transfer of control. However, we do support requests for additional guidance on management contracts and de facto control standards. Our position is outlined in our Petition for Reconsideration in this proceeding.²⁷

²³ Id.

²⁴ NABOB, pp. 7-8.

²⁵ Columbia PCS, pp. 5-6.

²⁶ Id.

²⁷ PBMS, pp. 9-11.

VII. THE RULES ON THE TRANSFERS OF LICENSES BY DES SHOULD PROVIDE AN EXCEPTION FOR DES IN FINANCIAL DIFFICULTY.

Under the current rules a DE cannot transfer its license to any party for the first three years and for the next two years it can only transfer the license to another DE.²⁸ AIDE opposes this restriction because it notes that the rule could have a very unfair effect. If the business is losing money in the first three years, it must go bankrupt before the license can be transferred.²⁹

We appreciate the Commission's desire to ensure the DEs are actually operating the PCS system. On the other hand, the rules should not force a DE that is having financial difficulties into bankruptcy before its license can be transferred. As AIDE notes, the unjust enrichment provisions already exist to prevent a non-DE from obtaining advantages created for the DE.³⁰

VIII. THE LIMIT ON VOTING STOCK AVAILABLE TO PASSIVE INVESTORS SHOULD BE RAISED.

Omnipoint notes that the Commission raised the limit on voting stock held by passive investors from 5% to 15%. Omnipoint states that a 20% voting stock threshold would

²⁸ Fifth Report and Order, p. 128.

²⁹ AIDE, pp. 17-18.

³⁰ Id. at p. 17.

maximize financing opportunities and would not jeopardize the Commission's goal of preventing ineligible parties from exerting undue control.³¹ BET Holdings, Inc. recommends raising the level to 25% voting stock for passive investors.³²

We agree that the amount of voting stock held by passive investors should be raised to at least 20%. As Omnipoint notes, the 20% standard is consistent with the Financial Accounting Standards Board concept of control.³³

IX. CONCLUSION.

For the foregoing reasons, Pacific Bell Mobile Services respectfully requests the Commission to reject those petitions for reconsideration that seek changes in rules relating to the operation of the auction; that seek additional spectrum for DEs and that seek to change cellular eligibility requirements. We support those petitions for reconsideration that request increases in voting stock of passive investors, that request changes in the rules regarding transferability of DE licenses, and that seek guidance on de facto control/management contract issues. Finally, we recommend some

³¹ Omnipoint, p. 10.

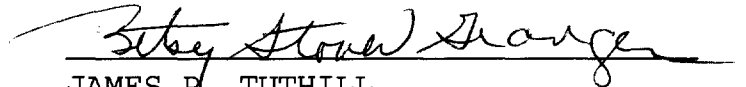
³² BET Holdings Inc., p. 15.

³³ Omnipoint, p. 10.

modifications to auction rules, as described in Professor
Milgrom's Affidavit.

Respectfully submitted,

PACIFIC BELL MOBILE SERVICES

A handwritten signature in cursive script, reading "Betsy Stover Granger", written over a horizontal line.

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Date: September 9, 1994

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

Affidavit of Paul R. Milgrom

1. My name is Paul R. Milgrom. I am the Shirley and Leonard Ely, Jr. Professor of Humanities and Sciences and Professor of Economics at Stanford University in Stanford, California, 94305. My background and experience are set forth in my November 8, 1993 affidavit which was attached to the comments of Pacific Bell and Nevada Bell filed November 10, 1993 in the P.P. Docket No. 93-253 in the Matter of Implementation of Section 309(j) of the Communications Act (Competitive Bidding).

2. I have been asked by Pacific Bell Mobile Services to comment on issues concerning the conduct of the broadband auction raised in the petitions for reconsideration of the Fifth Report and Order in P.P. Docket No. 93-253 filed by GTE Service Corporation, McCaw Cellular Communications and Metrex Communications Group, Inc. The responses to GTE also includes a brief discussion of possible beneficial modifications to the Milgrom-Wilson rule for the broadband auction.

RESPONSE TO METREX

3. Metrex suggests that the auction stopping rule be modified to end the bidding for individual BTA licenses on a license-by-license basis. It appears to suggest that bidding on a license be terminated after five consecutive rounds with no new activity on that license. The recent experience of the narrowband auction contradicts Metrex's idea that an early closing of individual licenses after a period of inactivity would be beneficial. But even if such an objective were desirable, adopting Metrex's particular suggestion is undesirable, because the Metrex rule would open several potentially damaging new strategic options to bidders in the auction.

4. A review of the narrowband auction experience indicates that, in a

simultaneous auction, long periods of inactivity on individual licenses followed by bursts of renewed activity can be part of a normal and constructive pattern. In the narrowband auction, licenses N-1 through N-4 each experienced spells of ten rounds or more with no new bidding activity beginning at round 18, largely because their prices were high relative to closely substitutable licenses. When activity on these four licenses resumed, the prices for each of them rose by an additional \$10 million before the bidding finally stopped. Similarly, after an initial bid of \$10 million for license N-10 on the first round, that license drew no new bids until round 13, as bidders focussed first on the more valuable licenses. Later, N-10 became the object of intense bidding competition: Its price eventually rose from \$10 million to \$37 million. *If effective*, Metrex's suggestion would rule out similar patterns in the broadband BTA auction, preventing bidders from responding to current information about prices and from switching among licenses as necessary to execute their back-up strategies.

5. However, Metrex's proposed rule would not likely be effective. Instead, the rule would open up a wide range of new strategic options for bidders, diverting attention from the serious business of determining license values and damaging the efficiency of the auction. For example, facing the Metrex rule, a bidder might choose to keep its back-up plan available by bidding in every fifth round on the relevant licenses to prevent the bidding on those licenses from closing. To disguise its back-up plan, a bidder might also bid to keep open licenses on which it is not genuinely interested. It might also make occasional bids that keep a competitor from securing its pivotal market in order to discourage that competitor from bidding aggressively in adjacent markets, or it might make high early bids to force competitors to make equally early decisions about the relative value of some back-up option. With these and other strategic bidding options opened by the Metrex rule, the net result would be to increase the randomness of the license assignment and perhaps to increase relative importance of bidding acumen and reduce that of the underlying economic values in determining the auction outcome.

6. A great advantage of the simultaneous closing rule that the Commission has adopted is that it minimizes the ability of bidders to manipulate the auction process and encourages bidders to devote more attention to the fundamentals of business decision-making. The failures of “jump bidding” and other stratagems in the recent narrowband auction to deter bidding competition illustrate how resistant the simultaneous stopping rule is to such attempts at manipulation. Instead, the rule allows each bidder ample opportunity to express its values through its bids and to switch to back-up strategies when the primary bidding strategies become too expensive. The simultaneous stopping rule is a crucial feature of the simultaneous auction design; it should not be modified.

RESPONSE TO MCCAW

7. McCaw Cellular recommends that bidding rounds should be made less frequent than previously planned, beginning with no more than two rounds per week and slowing to one round per week in the advanced stages of the auction. It argues that “the broadband auctions are likely to require frequent consultation with lenders, corporate board members, and technical staff, as well as among any joint venture partners or consortium members. The logistics of arranging financing and obtaining appropriate corporate approvals, particularly if the bid amounts considerably exceed anticipated levels, may take more than one business day.”¹

8. The McCaw proposal should be rejected both because it would result in the auction taking far too long – probably more than a year if the Commission did not exercise its option to call for a final round of bids – and because McCaw has exaggerated the difficulties that bidders face in a faster paced auction.

9. Recall that the narrowband auction, involving only ten licenses, took 47 rounds to complete – there being no new bids on round 47. Most of the non-winners

¹Page 4 of their petition for reconsideration.

had dropped out of the auction by round 10. Applying the McCaw rule in the narrowband auction would have meant that five weeks were used for the first ten rounds, followed by 37 weeks for the remaining rounds, for a total of 42 weeks. Such a long auction would needlessly delay the introduction of PCS services, which would benefit only existing cellular providers while harming consumers and new wireless competitors.

10. McCaw's conclusion that bidders need longer rounds to bid effectively does not follow from its single premise, but requires the additional premise that the bidders will be assessing license values, making financing arrangements, and determining bidding strategies round-by-round during the course of the auction. This second premise is flawed. Most of the work that needs to be done to determine values of various licenses or combinations of licenses will be done before the auction is conducted. As in takeover contests, bidders in these auctions will seek financing commitments, such as standby letters of credit, before the auction commences. If new financing arrangements need to be made during the auction, the bidders hardly need to wait until their credits would otherwise be exhausted to begin making arrangements; negotiations with creditors can begin weeks in advance. Similarly, there hardly needs to be a continuous full meeting of the company board of directors before every round of bids. Boards can work out streamlined procedures for daily decisions, supplemented by teleconferencing at crucial points during the auction. Similar expedited procedures can be worked out with joint venture and consortium partners.

11. Moreover, there are margins of safety built into the overall auction process using the Milgrom-Wilson activity rule. If, during phases 1 and 2 of the auction, bidders interested in acquiring multiple licenses find themselves needing more time to arrange increased financing, the activity rule allows them adequate slack. Such a bidder can retain its full eligibility by being active on just $1/3$ (during phase 1) or $2/3$ (during phase 2) of the spectrum for which it wishes to remain eligible. Only in phase 3, after the pace of new bidding has substantially subsided, must all the still-active

bidders have arranged financing for the spectrum that they still hope to acquire. Moreover, in all three phases, each bidder can exercise a waiver to allow itself additional preparation time. The long rounds proposed by McCaw are unnecessary.

12. The appropriate length of rounds depends partly on the number of rounds that will be required to complete the auction. Although that number is not completely predictable, one can identify some of the key factors on which it depends. Values are one key factor: the fact that the values of the narrowband spectrum were many times higher than some public estimates meant that the initial bids in that auction, which initially seemed high to outside observers, were actually a small fraction of the final winning bids. Building up from such relatively low initial bids extended the length of the auction. (It would, of course, be a mistake to take any action to limit the number of bidding rounds based on this experience. The extra rounds in the narrowband auction allowed the bidders with the highest values to outbid their competitors, probably resulting in a more efficient assignment of licenses, and also permitted the auction to generate unexpectedly high levels of revenue for the Treasury.)

13. A second factor determining the number of rounds of the auction is the complexity of the back-up strategies. In the narrowband auction, there was an ebb and flow of bidding activity as first one group of licenses and then another received new bids, as bidders readjusted the type of spectrum packages they sought to acquire. The broadband auction might involve more complicated and intertwined back-up strategies. One bidder's new activity on a license might cause a second bidder to withdraw bids or to switch to its own back-up, and the effects may cascade. In long auction scenarios for the broadband MTA auction, there could be more than 100 rounds. If the McCaw proposal were adopted, this could lead to an auction taking about two years to complete. If such a scenario began to emerge, it is more likely that the Commission would exercise its emergency termination rule, announcing that there will be just three more rounds of bidding. That, too, would be a highly undesirable outcome. By preventing the bidders with the highest valuations from